

Message Text

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ACTION EA-12

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TO SECSTATE WASHDC 0096
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AMEMBASSY TOKYO
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AMEMBASSY SINGAPORE
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AMEMBASSY KUALA LUMPUR
AMEMBASSY JAKARTA
AMEMBASSY WELLINGTON
AMEMBASSY CANBERRA
AMEMBASSY VIENTIANE
AMEMBASSY RANGOON
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USLO PEKING
CINCPAC HONOLULU

UNCLAS SECTION 1 OF 3 HONG KONG 5259

STATE FOR EA/PRCM AND EA/EP
CINCPAC FOR POLAD

E.O. 11652: N/A
TAGS: EINV, EFIN, EIND, HK, CH
SUBJECT: HONG KONG INVESTMENT CLIMATE

REF: 77 STATE 244738

1. THE EXCHANGE RATE USED THROUGHOUT THIS APPRAISAL OF THE CURRENT
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INVESTMENT CLIMATE IN HONG KONG IS US\$1.00 EQUALS HK\$4.60; ALL
FIGURES ARE GIVEN IN US DOLLARS. COPIES OF THE MOST RECENT
HONG KONG GOVERNMENT INVESTMENT PROMOTION BROCHURE AND CITIBANK
INVESTMENT GUIDE WILL BE POUCHED TO EA/PRCM AND EA/EP.

2. SUMMARY. HONG KONG WELCOMES OVERSEAS INVESTMENT, AND THE HONG
KONG GOVERNMENT ACTIVELY SOLICITS FOREIGN CAPITAL FOR THE

TERRITORY'S MANUFACTURING INDUSTRIES. LOW TAX RATES, DOMESTIC POLITICAL STABILITY, EXCELLENT COMMUNICATIONS, A SKILLED AND INDUSTRIOUS WORKFORCE AND PRUDENT GOVERNMENT FINANCIAL MANAGEMENT CONTINUE TO BE THE PRINCIPAL INCENTIVES FOR FOREIGN INVESTORS IN HONG KONG. WHILE HONG KONG'S FUTURE AFTER 1997 REMAINS OFFICIALLY UNRESOLVED, THE CHINESE GOVERNMENT HAS GIVEN PROGRESSIVELY STRONGER SIGNALS OVER THE LAST YEAR THAT IT WANTS THE STATUS QUO MAINTAINED INDEFINITELY. END SUMMARY.

3. GOVERNMENT POLICIES

THROUGH ITS TRADE, INDUSTRY AND CUSTOMS DEPARTMENT, THE HONG KONG GOVERNMENT ACTIVELY SOLICITS FOREIGN CAPITAL AND TECHNOLOGY FOR THE TERRITORY'S MANUFACTURING SECTOR. THE PRIVATE HONG KONG GENERAL CHAMBER OF COMMERCE ALSO OPERATES PROGRAMS TO PROMOTE FOREIGN INVESTMENT. GOVERNMENT STATISTICS SHOWED \$430.1 MILLION IN FOREIGN CAPITAL INVESTED IN HONG KONG MANUFACTURING INDUSTRIES AT YEAR-END 1977, A 6.4 PERCENT INCREASE ON THE YEAR BEFORE, AND A 230 PERCENT INCREASE FROM 1970. THE SINGLE LARGEST SOURCE OF FOREIGN CAPITAL, AMERICAN INTERESTS ACCOUNT FOR ROUGHLY 47 PERCENT OF THE CURRENT TOTAL, WITH OTHER MAJOR SOURCES BEING JAPAN (19.9 PERCENT) AND BRITAIN (7.5 PERCENT). HONG KONG'S GROSS DOMESTIC FIXED CAPITAL FORMATION HAS GROWN AT AN AVERAGE ANNUAL RATE OF 21.1 PERCENT (REAL TERMS) THROUGH THE 1970S, WHILE ITS INVESTMENT/GDP RATIO HAS HELD ABOVE 22 PERCENT OVER THE SAME PERIOD.

4. EXAMINED BY INDUSTRY, THE VALUE OF OVERSEAS INVESTMENT UNCLASSIFIED

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IN HONG KONG MANUFACTURING IS DISTRIBUTED AS FOLLOWS:

ELECTRONICS	26.1 PERCENT
TEXTILES	15.8 PERCENT
CHEMICAL PRODUCTS	11.9 PERCENT
ELECTRICAL PRODUCTS	10.2 PERCENT
PRINTING AND PUBLISHING	7.1 PERCENT
WATCHES, CLOCKS AND ACCESSORIES	6.8 PERCENT
METAL PRODUCTS	4.8 PERCENT
FOOD MANUFACTURES	3.7 PERCENT
TOYS	3.1 PERCENT
METAL ROLLING EXTRUSION AND FABRICATION	2.8 PERCENT
BUILDING AND CONSTRUCTION MATERIALS	1.7 PERCENT
OTHERS	6.0 PERCENT
TOTAL	100.0

5. THE HONG KONG GOVERNMENT DOES NOT COLLECT DATA ON INFLOWS OF FOREIGN CAPITAL FOR SECTORS OTHER THAN MANUFACTURING, BUT THEY MUST BE SIGNIFICANT. AMERICAN EQUITY ALONE--IN REAL ESTATE, TRANSPORTATION/FACILITIES, OIL STORAGE DEPOTS--PROBABLY EXCEEDS THE 200.1 MILLION INVESTED IN MANUFACTURING. THE HONG KONG GOVERNMENT HAS NO RESTRICTIONS ON FOREIGN OWNERSHIP OF PROPERTY IN THE TERRITORY.

6. TAXATION

ALTHOUGH HONG KONG OFFERS NO SPECIAL TAX INCENTIVES TO FOREIGN INVESTORS, ITS LOW RATES AND SIMPLE STRUCTURE OF TAXATION HAVE PROVEN ATTRACTION ENOUGH. TAXES ARE LEVIED ONLY ON EARNINGS AND PROFITS ORIGINATING IN HONG KONG. CORPORATIONS ARE TAXED AT A FLAT 17 PERCENT OF AGGREGATE PROFITS, AND THE TAX ORDINANCE ALLOWS LIBERAL DEPRECIATION OF FIXED ASSETS. PERSONAL SALARIES ARE TAXED ON A GRADUATED SCALE TO A MAXIMUM OF 15 PERCENT. MISCELLANEOUS DUTIES AND A REAL ESTATE TAX, THROUGH WHICH PROPERTY OWNERS (OR LESSORS) SHARE THE COST OF URBAN SERVICES, MIGHT ADD SLIGHTLY TO AN INVESTOR'S TAX LIABILITY; BUT HONG KONG STILL HAS THE LOWEST OVERALL TAX RATES IN ASIA. AND THE GOVERNMENT INTENDS TO KEEP THINGS UNCLASSIFIED

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7. DESPITE LOW RATES, TAXES PROVIDE HALF THE HONG KONG
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GOVERNMENT'S REVENUE, WITH 40 PERCENT COMING FROM PROFITS AND EARNINGS TAXES ALONE. THE GOVERNMENT BUDGET, \$2.2 BILLION FOR THE FINANCIAL YEAR BEGINNING APR 1 1978, HAS SHOWN HEALTHY SURPLUSES FOR ALL BUT ONE OF THE LAST TEN YEARS. EXCLUDING THE \$350 MILLION GOVERNMENT-GUARANTEED BORROWING BY THE SUBWAY CORPORATION, HONG KONG HAS LESS THAN \$50 MILLION IN PUBLIC DEBT OUTSTANDING.

8. AS ITS BUDGET MANAGEMENT SUGGESTS, THE HONG KONG GOVERNMENT HAS A STRONG COMMITMENT TO LAISSEZ-FAIRE ECONOMICS. THE GOVERNMENT BELIEVES FIRMLY IN LETTING MARKET FORCES WORK FREELY AND POINTS TO HONG KONG'S POST-WAR PROSPERITY AS PROOF TO A FREE MARKET'S VIRTUES. HONG KONG'S REAL GDP GROWTH HAS AVERAGED 8.9 PERCENT SINCE 1965, WHILE CONSUMER PRICE INFLATION HAS HELD AT ABOUT 5 PERCENT PER YEAR, EXCEPT FOR THE ABERRATIONS CAUSED BY WORLDWIDE INFLATION IN 1973-74. LIVING COSTS FOR EXPATRIATES, HOWEVER, HAVE CLIMBED FASTER THAN THE GENERAL PRICE INDICES, PARTICULARLY AS RESIDENTIAL REAL ESTATE VALUES HAVE RISEN SHARPLY IN THE LAST 10 YEARS. CURRENT HOUSING COSTS FOR EUROPEAN AND AMERICAN EXECUTIVES ARE HIGH; THE HONG KONG AMERICAN CHAMBER OF COMMERCE ESTIMATES THAT ITS MEMBERS PAY AN AVERAGE OF \$1500 PER MONTH IN RENT ALONE, EXCLUDING UTILITIES AND REAL ESTATE TAXES.

9. HONG KONG'S ECONOMY
MERCHANDISE EXPORTS ACCOUNT FOR BETWEEN 80 AND 90 PERCENT OF HONG KONG'S GDP, WHICH REACHED \$11.8 BILLION, \$2622 PER CAPITA, IN 1977. LAST YEAR, DOMESTIC EXPORTS TOTALLED \$7.6 BILLION, WITH THE PRINCIPAL PRODUCTS BEING GARMENTS (\$3 BILLION), TOYS AND DOLLS (\$600 MILLION), TRANSISTOR RADIOS (\$460 MILLION), TEXTILE FABRICS (\$414 MILLION), WATCHES AND CLOCKS (\$363 MILLION) AND

ELECTRONICS COMPONENTS (\$228 MILLION). RE-EXPORTS ADDED \$2.1 BILLION TO BRING THE 1977 MERCHANDISE EXPORT TOTAL TO UNCLASSIFIED

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\$9.7 BILLION; IMPORTS AMOUNTED TO \$10.5 BILLION, LEAVING AN \$800 MILLION TRADE DEFICIT. BUT THIS DEFICIT WAS, AS USUAL, MORE THAN OFFSET BY TOURIST EXPENDITURES.

10. HONG KONG HAS NO NATURAL RESOURCES AND MUST IMPORT NEARLY EVERYTHING IT CONSUMES, INCLUDING MOST OF ITS FOOD AND ONE-FOURTH OF ITS WATER. HONG KONG IS ESSENTIALLY A FREE PORT, WITH HYDROCARBON OILS, TOBACCO PRODUCTS AND ALCOHOLIC BEVERAGES THE ONLY DUTIABLE COMMODITIES.

11. LAND.

UNLIKE MANY ASIAN COUNTRIES, HONG KONG HAS NO OFFICIAL INDUSTRIAL DEVELOPMENT BOARD THAT ALLOCATES REAL ESTATE TO DESIRABLE FOREIGN INVESTORS, ALTHOUGH AN "INDUSTRIAL ESTATES PROVISIONAL AUTHORITY" HAS RECENTLY BEEN ESTABLISHED TO PLAN FOR HEAVIER INDUSTRIES. GOVERNMENT LAND POLICIES DO NOT DISCRIMINATE BETWEEN LOCAL AND FOREIGN INVESTORS, AND THE GOVERNMENT GIVES ANY INVESTOR WHOSE PLANNED MANUFACTURING FACILITY WILL INTRODUCE NOVEL TECHNOLOGY TO HONG

KONG PREFERENTIAL ACCESS TO NEWLY FORMED PUBLIC LAND. TWO LARGE US MANUFACTURERS HAVE RECENTLY TAKEN ADVANTAGE OF THIS PREFERENCE AND HAVE BEEN WELL SATISFIED WITH THE HONG KONG GOVERNMENT'S HELP IN SITING THEIR PLANTS. PUBLIC LAND NOT SOLD BY PRIVATE TREATY IS USUALLY SOLD AT AUCTION.

12. LAND IS PERHAPS HONG KONG'S DEAREST RESOURCE, AND PRICES REFLECT ITS SCARCITY. AS ONE RESULT, HONG KONG'S ECONOMIC GROWTH HAS DEPENDED ON LIGHT MANUFACTURES AMENABLE TO ASSEMBLY IN HIGH-RISE INDUSTRIAL BUILDINGS. FOR NEW INDUSTRIES THAT MUST SPREAD OUT RATHER THAN UP, THE GOVERNMENT IS ACTIVELY PREPARING LAND, BY FLATTENING HILLS AND RECLAIMING SHALLOW INLETS: SOME 535 HECTARES SHOULD BECOME AVAILABLE FOR INDUSTRIAL USE IN THE NEXT FOUR YEARS. NEVERTHELESS, LAND PRICES IN HONG KONG WILL ALWAYS BE RELATIVELY HIGHER THAN ELSEWHERE IN SOUTHEAST ASIA, AND THESE COSTS HAVE DISCOURAGED SOME OVERSEAS INVESTMENT.

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13. LABOR

HONG KONG'S LABOR FORCE NUMBERS ABOUT 1.9 MILLION PERSONS, WITH APPROXIMATELY 41 PERCENT EMPLOYED IN MANUFACTURING, 14 PERCENT IN WHOLESALE AND RETAIL TRADE AND 6 PERCENT IN RESTAURANTS AND HOTELS.

FINANCIAL AND BUSINESS SERVICES, CONSTRUCTION AND GOVERNMENT ARE THE OTHER SECTORS EMPLOYING SIGNIFICANT NUMBERS OF PEOPLE. THE LABOR FORCE IS PREDICTED TO GROW AT ABOUT 3 PERCENT ANNUALLY THROUGH THE MID-1980S BUT THEREAFTER INCREASE AT LESS THAN 1.5 PERCENT PER YEAR.

14. HONG KONG'S LABOR MARKET HAS BEEN TIGHT SINCE 1976 AND WILL PROBABLY CONTINUE SO THROUGH 1978. AVERAGE DAILY WAGES FOR INDUSTRIAL WORKERS HAVE RISEN 8.5 PERCENT SINCE EARLY 1976 AND MORE RAPIDLY FOR OTHER WORKERS. DAILY WAGES FOR MANUFACTURING WORKERS NOW AVERAGE \$7.60, ALTHOUGH SKILLED INDUSTRIAL AND CONSTRUCTION WORKERS CAN EARN MORE THAN \$30 A DAY. NONETHELESS, MOST FOREIGN EMPLOYERS CONSIDER HONG KONG WORKERS WORTH THEIR WAGES AND AMONG THE MOST DILIGENT, PRODUCTIVE AND SKILLED IN ASIA. HONG KONG LABOR UNIONS, ALTHOUGH THEY ENROLL ABOUT ONE-FOURTH OF THE TOTAL WORKFORCE, LACK MILITANCE AND RESEMBLE POLITICAL CLUBS OR BENEVOLENT SOCIETIES. WORKERS SELDOM STRIKE. NO SIGNIFICANT WORK STOPPAGES HAVE BEEN RECORDED SINCE THE POLITICAL DISTURBANCES OF 1967 (SEE PARA 15). GOVERNMENT EDUCATION POLICIES AIM TO IMPROVE WORKFORCE SKILLS FOR PROMISING EXPORT INDUSTRIES, AND TO PROVIDE MORE TECHNICAL AND TECHNOLOGICAL TRAINING FOR HIGH SCHOOL GRADUATES.
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15. POLITICS
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HONG KONG'S DOMESTIC POLITICS HAVE THE ORDERLINESS THAT ONLY A BUREAUCRATIC COLONIAL GOVERNMENT--AND EVER-RISING STANDARDS OF LIVING--CAN CREATE. MOST RESIDENTS, IF NOT UTTERLY APOLITICAL, APPRECIATE THE SUBTLETIES OF HONG KONG'S UNIQUE INTERNATIONAL STATUS. THOSE FAMILIAR WITH THE CONCEPT REALIZE THAT WESTERN-STYLE DEMOCRACY WILL NEVER COME TO HONG KONG. NEVERTHELESS, THE GOVERNMENT USUALLY ACTS IN ACCORDANCE WITH THE POPULAR CONSENSUS, WITH SEVERAL CONSULTATIVE MECHANISMS ESTABLISHED TO DISCERN POPULAR SENTIMENT. PUBLIC ORDER HAS NOT BEEN SERIOUSLY THREATENED SINCE 1967, WHEN RIOTS RELATED TO POLITICAL TURBULENCE IN CHINA OCCURRED.

16. OTHER INCENTIVES TO FOREIGN INVESTMENT
ALTHOUGH 98 PERCENT OF KONG'S 4.6 MILLION PEOPLE ARE CHINESE, THE TERRITORY'S URBAN CENTERS DRAMATICALLY SYMBOLIZE ITS WESTERN CONNECTIONS. ALSO IMPORTANT TO PROSPECTIVE INVESTORS, HONG KONG OFFERS EFFICIENT INTERNAL AND INTERNATIONAL COMMUNICATIONS, COMPLETE FINANCIAL SERVICES, AND EXCELLENT SHIPPING, TRANSPORTATION AND MARKETING FACILITIES. THERE ARE NO FOREIGN EXCHANGE CONTROLS. FOR MANY FOREIGN INVESTORS, HONG KONG'S LOCATION ITSELF IS INCENTIVE ENOUGH.

17. HONG KONG'S FUTURE
IN THE LAST YEAR, QUESTIONS ABOUT HONG KONG'S FUTURE HAVE BEEN RAISED WITH INCREASING FREQUENCY FROM MANY SIDES, POTENTIAL FOREIGN INVESTORS NOT LEAST AMONG THEM. WITHOUT EXPLICATING THE SUBTLETIES OF HONG KONG'S CURRENT POLITICAL STATUS, SUFFICE IT TO SAY THAT QUESTIONS FOCUS ON HONG KONG AFTER JULY 1997, WHEN THE NEW TERRITORIES (94 PERCENT OF HONG KONG'S LAND AREA) LEASE EXPIRES. ALTHOUGH THE CHINESE AUTHORITIES DO NOT

RECOGNIZE THE LEASE AS LEGALLY BINDING, THE BRITISH DO. AND, SINCE THE GOVERNMENT ULTIMATELY OWNS ALL OF HONG KONG'S LAND, OR MORE PRECISELY IS THE "LESSOR" IN THE NEW TERRITORIES, IT WILL
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GRANT NO LEASE THAT RUNS BEYOND JULY 1997.

18. THUS FAR, UNCERTAINTIES 19 YEARS DOWN THE ROAD HAVE NOT RETARDED INVESTMENT GROWTH OR BANKS' WILLINGNESS TO FINANCE NEW INVESTMENT. MOST INVESTORS IN LIGHT MANUFACTURING EXPECT FULL RETURN ON CAPITAL IN 5 TO 10 YEARS, AND HAVE NOT REALLY FACED THE 1997 TABOO DATE. BUT LONGER TERM COMMITMENTS, AT LEAST FROM OVERSEAS INVESTORS, WILL PROBABLY REQUIRE MORE EXPLICIT ASSURANCES ABOUT HONG KONG'S TWENTY FIRST CENTURY STATUS. WE HAVE SEEN, NONETHELESS, FRESH SIGNS OF FOREIGN INVESTOR CONFIDENCE IN THE TERRITORY'S LONG-RANGE POTENTIAL; AN AMERICAN OIL COMPANY HAS RECENTLY COMMITTED \$360 MILLION TO A NEW ELECTRIC POWER PLANT, AND HONG KONG'S NEW SUBWAY SYSTEM HAS HAD NO TROUBLE OBTAINING FOREIGN BANKS' CREDITS WITH MID-1990S MATURITIES.

19. THE HONG KONG GOVERNMENT REGULARLY NOTES THAT HONG KONG-PEKING RELATIONS REMAIN, IN THE GOVERNOR'S WORD "EXCELLENT", AND NEVER FAILS TO STRESS CHINA'S WILLING COOPERATION ON MATTERS OF MUTUAL INTEREST. PEKING FOR ITS PART HAS REASSURED INVESTORS IN UNUSUALLY STRAIGHTFORWARD FASHION THAT IT ANTICIPATES NO CHANGE SOON IN HONG KONG'S STATUS. PEOPLE'S REPUBLIC OF CHINA (PRC) INTERESTS KEEP SUBSTANTIAL INVESTMENTS IN HONG KONG AND HAVE RECENTLY INCREASED THESE WITH WELL PUBLICIZED REAL ESTATE ACQUISITIONS INTENDED FOR BOTH COMMERCIAL AND INDUSTRIAL USE. THE PRC HAS PAID SPECIAL ATTENTION TO HONG KONG CHINESE CAPITALISTS, LAST YEAR INVITING A GROUP OF PROMINENT REALTORS TO CELEBRATE CHINA'S NATIONAL DAY IN PEKING.

20. IN THE CONSULATE'S ASSESSMENT, SHARED BY MOST HONG KONG BUSINESS ANALYSTS, HONG KONG WILL CONTINUE TO EXIST IN ITS PRESENT STATUS SO LONG AS PRAGMATIC LEADERS GOVERN CHINA. HONG KONG OFFERS TOO MANY ADVANTAGES FOR A DEVELOPING CHINA TO JEOPARDIZE BY POLITICAL ACTION. HONG KONG YIELDS ANNUALLY ABOUT 40 PERCENT OF CHINA'S HARD-CURRENCY INCOME, FROM DIRECT SALES IN HONG KONG, RE/EXPORTS AND REMITTANCES. A
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PROSPEROUS, CAPITALIST HONG KONG APPEARS TO BE IN CHINA'S BEST INTERESTS, BUT HONG KONG'S PROSPERITY WILL CONTINUE TO REMAIN HOSTAGE TO CHINA'S DESIRES.

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